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SIPDIS

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SUBJECT: FIAT IN CRISIS: GOI BETWEEN A ROCK AND A HARD PLACE

REF: A. ROME 5049

- [1](#)B. ROME 473
- [1](#)C. ROME 3885

CLASSIFIED BY: ECONOMIC INISTER-COUNSELOR SCOTT KILNER FOR REASONS 1.5
() AND (D)

[1](#)1. (SBU) SUMMARY: FIAT, ITALY'S LARGEST CORPORATION AND NATIONAL ICON, IS IN THE MIDST OF A POTENTIALLY DEVASTATING CRISIS AS ITS SUBSIDIARY, FIAT AUTO, FACES THE CONSEQUENCES OF DECADES OF MOUNTING LOSSES AND EBT. THE CRISIS OF FIAT AUTO CRISIS IS HITTING ITALY HARD ECONOMICALLY AND POLITICALLY. LABOR IS P IN ARMS OVER POSSIBLE JOB CUTS THAT COULD NUMBER IN THE TENS OF THOUSANDS. THE POWERFUL AGNELLI FAMILY, WHICH OWNS THE FIAT EMPIRE, IS USING ITS INFLUENCE TO PRESSURE THE GOI. GENERAL MOTORS, WHICH OWNS TWENTY PERCENT OF FIAT AUTO, IS WATCHING WARILY, AS FIAT'S TROUBLES COULD FORCE THE US AUTOMAKER TO UP ITS SHARE OF FIAT AUTO. THE GOI FACES A VERY REAL POLITICAL -- AND ECONOMIC -- DILEMMA AS A RESULT OF FIAT AUTO'S FINANCIAL FREEFALL. END SUMMARY.

FIAT AND NATIONALISM

[1](#)2. (U) FIAT AUTO WAS THE MODEL FOR ITALIAN POST-WAR
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INDUSTRIAL DEVELOPMENT. IT SPAWNED A CORPORATE EMPIRE (IFIL), INCLUDING ALL COMPANIES CONTROLLED BY THE AGNELLI FAMILY (FIAT AVIO, NEWS MEDIA, INSURANCE, AGRO-INDUSTRY, CONSTRUCTION EQUIPMENT, ALFA ROMEO, LANCIA, AND FERRARI, PIAGGIO, ETC.). IN THE 1960S, 20 PERCENT OF ALL ITALIAN INDUSTRIAL INVESTMENT IN SECTORS OTHER THAN THE AUTOMOTIVE SECTOR, INCLUDING SUCH AS STEEL AND PLASTICS -- DEPENDS DIRECTLY ON THE CORPORATE GIANT FIAT. IN 1964, AT THE END OF ITALY'S BOOM ECONOMIC YEARS, THE PRODUCTION OF THE AUTOMOTIVE SECTOR, OF WHICH 90 PERCENT WAS FIAT'S, ALONE ACCOUNTED FOR 3.5 PERCENT OF GDP AND TEN PERCENT OF THE OUTPUT OF THE OVERALL INDUSTRIAL SECTOR. TODAY, THE DIVERSIFIED FIAT CORPORATION AND THE BUSINESSES THAT DEPEND ON IT REPRESENT AN ESTIMATED FOUR PERCENT OF ITALY'S GDP. FIAT AUTO ALONE EMPLOYS APPROXIMATELY 200,000 PEOPLE (36,000 IN ITS PLANTS), MANY IN SOUTHERN ITALY. ALTHOUGH FIAT AUTO HAS EXPERIENCED ECONOMIC PROBLEMS FOR DECADES, IT REMAINS A POTENT SYMBOL AND DRIVER OF ITALY'S ECONOMY.

[1](#)3. (SBU) THE FIAT CORPORATION WAS FOUNDED IN 1899 BY GIOVANNI AGNELLI (THE GRANDFATHER OF THE CURRENT HONORARY CHAIRMAN, GIANNI AGNELLI). THE AGNELLI FAMILY RETAINS OWNERSHIP AND CONTROL. FROM THE FAMED CINQUECENTO CAR MODELS OF THE 1950S TO THE SEICENTO OF THE 1960S, FIAT AUTO HAS LONG BEEN A SOURCE OF NATIONAL PRIDE. HOWEVER TODAY, PUBLIC OPINION IS DIVIDED ON THE QUESTION OF OWNERSHIP AND FATE OF FIAT AUTO. SOME ITALIANS ARGUE THAT ITALY NEEDS TO MAINTAIN A NATIONAL AUTO INDUSTRY AT ALL COSTS TO PRESERVE ITS NATIONAL AND INTERNATIONAL PRESTIGE. OTHERS DO NOT FEEL ANY ANTAGONISM TOWARD A FOREIGN BUY-OUT. MANY ITALIANS HAVE CONCLUDED THAT FIAT AUTO IS NO LONGER A VIABLE FIRM: ITS
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PRODUCTION IS TOO SMALL TO COMPETE INTERNATIONALLY; DESIGNS ARE NOT ADAPTED TO MARKET DESIRES, AND PRICES ARE TOO HIGH FOR THE LOW QUALITY OF CARS PRODUCED.
THE SITUATION TODAY

[1](#)4. (SBU) FIAT AUTO IS UNDERGOING ITS MOST SEVERE CRISIS EVER, THE CUMULATIVE PRODUCT OF ITS FAILURE OVER THE PAST 15 YEARS TO REMAIN COMPETITIVE WITH OTHER EUROPEAN AUTOMAKERS, LEADING TO MOUNTING LOSSES AND THE CRUSHING DEBT UNDER WHICH THE ENTERPRISE IS NOW SUFFOCATING (REF A). IN AN EFFORT TO RETRENCH, FIAT AUTO, WHICH HAD ALREADY CLOSED ITS FOREIGN PLANTS, HAS ANNOUNCED PLANS TO CLOSE TWO PLANTS AND TO LAY OFF ONE-THIRD OF ITS EMPLOYEES FROM ANOTHER. A REPORTED 8,000 FIAT AUTO WORKERS WILL BE LAID OFF. ANOTHER 24,000 WORKERS FROM FIAT SUPPLIER FIRMS ALSO COULD LOSE THEIR JOBS.

[1](#)5. (SBU) THE FIAT AUTO CRISIS COMES AT A TIME WHEN ITALY IS EXPERIENCING SIGNIFICANT ECONOMIC PROBLEMS. ITALY'S GDP

GROWTH IS LIKELY TO DECLINE TO 0.5 PERCENT IN 2002, A NEAR POST-WAR RECORD. ITALY'S DRAFT BUDGET, AWAITING PARLIAMENTARY APPROVAL, ALLOWS VERY LITTLE FLEXIBILITY AND IS GEARED TOWARD TIGHTENING FISCAL POLICY TO MEET EU STABILITY PACT TARGETS (REF C). THE COST OF FUNDING EXTENDED UNEMPLOYMENT BENEFITS FOR AFFECTED WORKERS (WHO WOULD RECEIVE UP TO 80 PERCENT OF

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THEIR SALARY FOR THREE YEARS, VIRTUALLY ALL OF IT PAID BY THE STATE) WOULD PLACE AN ADDITIONAL BURDEN ON THE GOI. (NOTE: UNEMPLOYMENT BENEFITS ARE NORMALLY PROVIDED FOR A YEAR AND DRAWN FROM A FUND FINANCED BY GOVERNMENT, MANAGEMENT AND LABOR. HOWEVER, FIAT AUTO CAN DECLARE THESE DISMISSALS TO BE AN &EXCEPTIONAL8 CIRCUMSTANCE AND REQUEST THAT ITS WORKERS RECEIVE LONGER-TERM BENEFITS, THEREBY SHIFTING THE DISMISSAL COSTS TO THE STATE. PROVISION OF THESE EXCEPTIONAL BENEFITS IS ONE FORM OF PUBLIC SUPPORT UNDER CONSIDERATION. END NOTE)

LABOR UP-IN-ARMS

16. (U) FOR ORGANIZED LABOR, THE FIAT AUTO CRISIS THREATENS NOT ONLY THOSE 32,000 (8,000 FIAT PLUS 24,000 SUPPLIER FIRM) WORKERS FACING DISMISSAL; ITS EFFECTS COULD REVERBERATE AND AFFECT THE 35-40 PERCENT OF THE WORKFORCE REPRESENTED BY UNIONS.

17. (SBU) EVEN BEFORE THE FIAT AUTO CRISIS BROKE, TWO OF THE THREE MAJOR CONFEDERATIONS WARNED THAT THEY WOULD TAKE TO THE STREETS IF THE BUDGET PROPOSAL FOR ECONOMIC DEVELOPMENT AND SUPPORT IN SOUTHERN ITALY FAILED TO PROVIDE SUFFICIENT FUNDS TO HONOR THE TERMS OF THE LABOR PACT (WHICH, INTER ALIA, ESTABLISHES 2003 WAGE RATES) THEY SIGNED WITH EMPLOYERS AND

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THE GOVERNMENT OVER THE SUMMER. THE LARGEST CONFEDERATION, CGIL, DECLARED THAT ITS NATIONWIDE GENERAL STRIKE OCTOBER 18 (ORIGINALLY CALLED TO PROTEST THE GOVERNMENT'S EFFORTS TO INTRODUCE MORE FLEXIBILITY INTO THE LABOR MARKETS) WAS TO PROTEST THE GOVERNMENT'S OVERALL ECONOMIC POLICY. OCTOBER 18 DEMONSTRATIONS IN TURIN (THE HOME OF FIAT), LED BY CGIL LEADER GUGLIELMO EPIFANI, TOOK ON A MUCH MORE STRIDENT AND COMBATIVE TONE AS A RESULT OF THE FIAT AUTO SITUATION.

18. (SBU) BUT IT'S NOT ONLY ABOUT JOBS. ALL THREE CONFEDERATIONS VIEW FIAT AUTO'S GAMBIT AS THE LATEST EXAMPLE OF A MANAGEMENT SECTOR THAT IS INCREASINGLY PREPARED TO JETTISON THE CUSTOMARY ITALIAN PRACTICE OF NEGOTIATING WAGES AND OTHER WORKPLACE ISSUES BY CONSENSUS. FIAT AUTO -) BOTH ITS TENUOUS POSITION AND ITS PROPOSED REMEDIES -) IS A CASE STUDY IN ITALIAN INDUSTRIALISTS, SKEWED PRIORITIES, THEY ARGUE. UNION OFFICIALS ACKNOWLEDGE THAT THEIR MEMBERS BENEFITED FROM THE LONG LIST OF PAST GOVERNMENT BAILOUTS, AND, IN THEIR EYES, RIGHTLY SO: ONE OF GOVERNMENT'S RESPONSIBILITIES AS A SOCIAL PARTNER IS TO SUPPORT INDUSTRY

(AND BY EXTENSION, ITS WORKERS) IN LEAN TIMES. IN RETURN, INDUSTRY SHOULD DEVOTE A PORTION OF ITS PROFITS IN GOOD TIMES TO ENSURING ITS LONG-TERM VIABILITY -) AN OBLIGATION FIAT AUTO HAS IGNORED, THEY CHARGE. THE COMPANY INVESTED LITTLE IN THE R&D AND DESIGN VITAL TO ENSURING THE COMPANY'S LONG-TERM HEALTH AND MARKET SHARE/POSITION (AND, BY EXTENSION, THE JOB SECURITY OF ITS WORK FORCE).

19. (SBU) THIS ACUTE SENSE OF BETRAYAL OF A LONG-ESTABLISHED SOCIAL COMPACT IS FELT MOST STRONGLY IN SICILY, WHERE THE 1,900-PLUS WORKERS AT FIAT,S TERMINI IMERESE FACTORY HAVE
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BLOCKED HIGHWAYS AND STAGED DEMONSTRATIONS TO PROTEST THEIR IMPENDING DISMISSAL. THE PLANT'S CLOSURE WOULD BE, IN THE EYES OF EVERYONE IN SICILY, FROM AFFECTED WORKERS TO LOCAL OFFICIALS TO MEMBERS OF PARLIAMENT, AN ABRUPT REVERSAL OF PAST STATE EFFORTS TO REDRESS LONG-STANDING REGIONAL ECONOMIC INEQUITIES BY SUBSIDIZING INDUSTRIAL DEVELOPMENT IN THE SOUTH. IN A REGION WHERE UNEMPLOYMENT TOPS 20 PERCENT, FIAT AUTO'S DECISION, THEY CHARGE, WILL LEAVE THE WORKERS AND AFFECTED COMMUNITIES ONLY ONE REAL ALTERNATIVE: ORGANIZED CRIME. TERMINI IMERESE,S CLOSURE, ARGUE LOCAL OFFICIALS, IS AN OPEN DOOR TO THE MAFIA.

FIAT PLAYS THE GAME

110. (C) THE AGNELLI'S TIMED THE ANNOUNCEMENT OF FIAT AUTO'S FINANCIAL WOES FOR MAXIMUM POLITICAL ADVANTAGE. AFTER CRITICISM OF THE GOI,S DRAFT BUDGET, AND ESPECIALLY OF ITS PROVISIONS FOR ITALY'S SOUTH, BY MANY IN ITALY'S POLITICAL AND BUSINESS ESTABLISHMENT (REF A), THE ANNOUNCEMENT OF FIAT AUTO'S MELTDOWN MADE CLEAR THAT THE COMPANY WOULD SEEK A SUBSTANTIAL SHARE OF GOVERNMENT RESOURCES IN ANY DEBATE REGARDING POSSIBLE BUDGET CHANGES. FIAT AUTO EXECUTIVES WERE QUICK TO PLAY UP THE PROSPECT OF MASS LAYOFFS IN FIAT AUTO'S SICILY PLANT. FIAT HAS LONG BEEN THE RECIPIENT OF GOVERNMENT

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LARGESSE IN PREVIOUS CENTER-LEFT ADMINISTRATIONS, AND FIAT MAGNATE GIANNI AGNELLI HAS FAR CLOSER TIES TO THE CENTER-LEFT POLITICAL ESTABLISHMENT THAN TO THE &UPSTART8 CENTER-RIGHT BERLUSCONI GOVERNMENT. THE ANNOUNCEMENT WAS A SHOT ACROSS THE GOVERNMENT BOW: BAIL US OUT OR PAY THE POLITICAL CONSEQUENCES.

111. (C) ADDING TO THE POLITICAL COMPLEXITY IS A LONG-SIMMERING FEUD BETWEEN AGNELLI AND BERLUSCONI. BERLUSCONI IS THE BRASH NOUVEAU RICHE TO AGNELLI,S OLD MONEY. AGNELLI IS THE ITALIAN POLITICAL ESTABLISHMENT, OVERTURNED BY THE VICTORY OF BERLUSCONI,S SMOOTH &FORZA ITALIA8 POLITICAL MACHINE. AGNELLI,S MAN, STAUNCHLY PRO-EUROPE RENATO RUGGIERO, WAS THE THORN IN BERLUSCONI,S SIDE AS FOREIGN MINISTER FOR THE FIRST MONTHS OF THIS PRIME MINISTERSHIP. ALLEGATIONS HAVE BEEN MADE THAT BERLUSCONI

SEEKS TO TAKE ADVANTAGE OF THE SITUATION TO BUY AGNELLI-OWNED SHARES IN INFLUENTIAL CENTRIST NEWSPAPERS, THUS INCREASING HIS MEDIA EMPIRE (AND NO DOUBT PROMPTING MORE HOWLS FROM THE OPPOSITION ABOUT GOVERNMENT CONTROL OF ITALY'S MEDIA.) EVALUATING THE EVENTUAL RESOLUTION OF THE FIAT AUTO PROBLEMS INVOLVES CALCULATING THE BALANCE OF POWER BETWEEN BERLUSCONI AND AGNELLI. BOTH HAVE STRONG LEVERS. SOME SUGGEST THE AGNELLI FAMILY'S POWER IS WANING, BUT THE POLITICAL PRESSURE ON THE GOI TO SAVE FIAT AUTO IS INTENSE.

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BANKRUPTCY NOT A LIKELY OPTION

112. (SBU) ITALIAN BANKS ENGINEERED A MASSIVE BAILOUT OF FIAT AUTO IN MID-2002. CONDITIONS ON THESE LOANS WERE STRICT, AND INCLUDED BANK VETO OF ANY CHANGE IN MANAGEMENT AND A RESTRUCTURING OF THE FIAT EMPIRE, WITH SALE OF PROFITABLE ASSETS (INSURANCE COMPANY TORO ASSICURAZIONE, FERRARI, FIAT AVIO, ETC.) PAYING DOWN THE DEBT BURDEN. ITALIAN BANKS HAVE REFUSED TO PROVIDE MORE FINANCING TO FIAT AUTO, AND HAVE CALLED ON THE GOI NOT TO INTERVENE. IN THE EVENT THAT FIAT AUTO WERE TO FILE -- UNDER DURESS -- FOR BANKRUPTCY, THE BANKS COULD FORCE FIAT TO SELL ITS REVENUE GENERATORS (TORO ASSICURAZIONI, FERRARI, FIAT AVIO, ETC.) YET BANKRUPTCY SEEMS AN UNLIKELY OPTION, IN NO ONE'S INTEREST: NOT THE GOVERNMENTS (POLITICAL FALLOUT AND COSTLY EFFECT ON GDP GROWTH); NOT THE BANKS (UNABLE TO RECOUP THEIR FINANCING OF FIAT AUTO); NOT LABOR (SIGNIFICANT JOB LOSSES ESPECIALLY IN THE STRUGGLING SOUTH). MOREOVER, THE FIAT CONGLOMERATE -- AS A WHOLE -- HAS BEEN ABLE TO MANAGE DEBT AND OPERATE AS A PROFITABLE ENTERPRISE THROUGHOUT ITS HISTORY. (NOTE: SPECULATION TODAY IS THAT THE BANKS' WILL BE FORCED TO BUY BACK THEIR DEBT AND BECOME SHAREHOLDERS IN FIAT. END NOTE.)

GM WAITING IN THE WINGS

113. (SBU) ALTHOUGH THERE WAS PREVIOUSLY LITTLE DOUBT THAT FIAT AUTO WOULD EVENTUALLY BE BOUGHT OUT BY GENERAL MOTORS, CLEARLY GM IS IN NO HURRY TO ACQUIRE THE FIRM. FIAT HAS A PUT OPTION TO SELL CONTROLLING INTEREST IN FIAT AUTO TO GM IN
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2004 AT MARKET PRICES. YET GM BLAMED ITS THIRD QUARTER LOSS ON ITS WRITE-DOWN OF THE VALUE OF ITS 20 PERCENT STAKE IN FIAT AUTO - FROM \$2.4 BILLION TO \$220 MILLION. GM MANAGEMENT HAS ANNOUNCED THAT GM WOULD CONSIDER THE PUT AGREEMENT VOID IF THERE WERE ANY MANAGEMENT CHANGES AT FIAT AUTO, AND ESPECIALLY IF THE GOI ACQUIRED ANY STAKE.

GOI FACING A CATCH-22

114. (C) THE GOI FACES A VERY REAL POLITICAL -- AND ECONOMIC -- DILEMMA AS A RESULT OF FIAT AUTO'S FINANCIAL FREEFALL. IT CAN ILL AFFORD TO SUPPORT FORMER FIAT AUTO WORKERS AT GOVERNMENT EXPENSE. AND IT CAN ILL AFFORD TO UNDERWRITE GREATER FIAT AUTO DEBT. BUT IT CAN EVEN LESS AFFORD TO ALIENATE THOSE WHO DEPEND ON THE COMPANY. HAVING WON THE ACQUIESCENCE OF CISL AND UIL TOWARD GOI PROPOSALS FOR MODERATE BEGINNINGS OF MUCH-NEEDED LABOR REFORM, THE GOI CANNOT WISH TO ANTAGONIZE THEM NOW. THE AGNELLI'S HAVE PLAYED THEIR CARDS WELL.

115. (C) AMONG THE GOVERNMENT'S CARDS, HOWEVER, IS THE GROWING RECOGNITION, AND RESENTMENT, OF THE FACT THAT WHEN FIAT AUTO WAS PROFITABLE, THE AGNELLI'S MADE MONEY. BUT WHEN FIAT AUTO IS IN DIFFICULTY, THE AGNELLI'S ALSO MAKE MONEY. WHEN, SOME

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ASK, WILL THE AGNELLI'S CONTRIBUTE SOME FINANCIAL ASSETS TO FIAT AUTO)- AND THE WORKERS)- IN RETURN? SOME ARE CALLING ON THE GOVERNMENT TO STAND FIRM AND INSIST ON AN AGNELLI FAMILY FINANCIAL CONTRIBUTION, AS WELL AS APPROPRIATE MANAGEMENT CHANGES AND RESTRUCTURING IN THE FIAT EMPIRE. EVEN SOME NOTED POLITICAL LEADERS ARE EXPRESSING THEIR FRUSTRATION WITH THE AGNELLI FAMILY. CENTRAL BANK GOVERNOR FAZIO TOLD AMBASSADOR SEMBLER ON OCTOBER 17 THAT THE AGNELLI'S DELIBERATELY NEGLECTED FIAT AUTO, NOT ENCOURAGING PRODUCT DESIGN OR IMPROVEMENT, FOR MORE THAN TWO DECADES. THE AGNELLI FAMILY WAS TOO COMPLACENT AND SELF-ASSURED THAT ITALIANS WOULD ALWAYS BUY FIAT AUTOS, EVEN IF BETTER OPTIONS WERE ON THE MARKET. FAZIO EMPHASIZED THAT THE BURDEN OF TURNING AROUND FIAT AUTO LIES WITH THE AGNELLI FAMILY.

¶16. (C) AFTER A MEETING BETWEEN FINANCE MINISTER TREMONTI AND FIAT AUTO'S CREDITOR BANKS, AND IN LIGHT OF THE REACTIONS FROM GM MANAGEMENT, THE GOI HAS TAKEN A STEP BACK FROM ANY IDEA OF DIRECTLY INVESTING IN FIAT AUTO. MINISTER FOR PRODUCTIVE ACTIVITIES MARZANO TOLD ECOMIN OCTOBER 17 THAT, BEFORE THE GOI PUT MORE MONEY INTO FIAT AUTO, FIAT NEEDED TO INSTITUTE A NEW AND VIABLE INDUSTRIAL PLAN. MARZANO SAID THAT OVER THE PAST YEAR AND A HALF THE GOI HAS FUNNELED OVER E2 BILLION INTO FIAT AUTO.

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¶17. (SBU) THE GOI ALSO NEEDS TO HEED EU COMPETITION POLICIES. THE EU COMMISSION, IN ACCORDANCE WITH REGULATIONS CONCERNING STATE SUBSIDIES, MUST AUTHORIZE ANY PLANNED FINANCIAL INTERVENTION. HOWEVER, EU PRESIDENT PRODI HAS MADE IT CLEAR THAT HE DOES NOT OPPOSE SUCH INTERVENTION. (NOTE: PRODI, A FORMER PRIME MINISTER OF ITALY, IS A POTENTIAL LEADER OF THE CENTER-LEFT COALITION AND A POSSIBLE NATIONAL-LEVEL CANDIDATE. END NOTE.) EU COMPETITION COMMISSIONER MONTI HAS SAID THAT THE EU IS "NEUTRAL" AS LONG AS THERE IS A VIABLE INDUSTRIAL PLAN AND THAT COMPETITION RULES ARE RESPECTED.

COMMENT: THE ROAD AHEAD

¶18. (C) AS DISCUSSIONS CONTINUE AMONG FIAT, THE BANKS, GM, LABOR AND THE GOI, SOME SCENARIOS SEEM MORE LIKELY THAN OTHERS. FIAT AUTO WILL ALMOST CERTAINLY DOWNSIZE ITS OPERATIONS BUT, UNDER GOI PRESSURE AND WITH A NOD TO LABOR, IS UNLIKELY TO CLOSE THE SICILY PLANT. WORKERS WILL LIKELY BE LAID OFF, BUT FEWER THAN FIRST ANNOUNCED. FIAT AUTO'S CREDITOR BANKS WILL CONTINUE TO PUSH FOR A RESTRUCTURING INVOLVING AN AGNELLI FAMILY CONTRIBUTION AND SALE OF OTHER FIAT ASSETS. THE AGNELLI'S WILL PUSH FOR FURTHER INJECTIONS OF BANK AND GOI FINANCIAL SUPPORT. FOR NOW, NEGOTIATIONS CONTINUE UNDER GOI AUSPICES.
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